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China's Second Revolution

National Intelligence Estimate

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NIE 13-7-86

CHINA'S SECOND REVOLUTION

Information available as of 15 May 1986 was used in the preparation of this Estimate, which was approved by the National Foreign Intelligence Board on 15 May 1986

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SCOPE NOTE

Chinese leader Deng Xiaoping in March 1985 characterized the reforms conducted since the Third Plenum of the 11th Central Committee in December 1978 as a "second revolution," which "is an unprecedented thing in China's history of thousands of years." These reforms involve fundamental political, economic, and social changes, probably the most comprehensive and systematic ever undertaken by a Communist regime. This Estimate considers what the second revolution is, how it is affecting Chinese institutions and society, and how it is likely to develop over the next 10 years. It also considers various courses these reforms might take and how they are likely to affect US interests.

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KEY JUDGEMENTS

China's far-reaching reform effort—unprecedented in Communist experience—has already achieved certain notable successes and is likely to continue, albeit at a somewhat reduced pace, over the next decade. This means that in the broader overall context China's power and influence will grow, a prospect that will offer both significant new long-term opportunities and challenges for the United States.

The principal goals of the reform movement—which in their totality clearly constitute a "second Chinese revolution"—are:

- *To restructure, reorient, and rejuvenate the political leadership.* This entails reorganizing and reforming the party; separating party and state functions; revamping ideology along more pragmatic lines; establishing stronger legal and institutional structures; and bringing younger, better educated, and more qualified personnel into positions of responsibility.
- *To expand the economy.* This entails narrowing the scope of central planning and gradually allowing market forces to determine more economic activity; improving efficiency, productivity, and quality in production; raising the standard of living; developing more effective financial institutions; gradually eliminating government involvement; promoting development of a relatively unregulated tertiary sector; opening China's economy to foreign participation; and giving priority to existing industrial bases.
- *To fashion a leaner, more professional military establishment.* This entails establishing a younger and more educated officer corps; reducing the overall size of the armed forces; constricting the role of the military in the economy and in politics; reorganizing military regions and commands; and acquiring and deploying improved weapons and equipment from domestic and foreign sources.
- *To create a society less constrained by political and social controls.*
- *To expand ties to the outside world that will assure China breathing space that will enable it to concentrate on its ambitious efforts to modernize and provide access to economic, scientific, and technical support.*

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In seeking these ends, *there will be significant constraints* that will fashion, slow, and under certain circumstances, possibly halt certain of the reform efforts for a time:

- *Deng Xiaoping and his supporters face the extremely difficult task of loosening certain controls*—in order to stimulate the receptivity, creativity, and flexibility necessary to achieve the goals of reform—*without, in the process, losing their own monopoly of power*. This basic contradiction may prove to be the single most vexing problem these leaders will confront, inasmuch as they believe they can establish far-reaching economic reform and yet maintain the leadership of the Party and the Marxist-Leninist character of the society.
- *Sharp differences exist among the leadership on some issues of the scope and pace of reform*. While we believe that the broad thrust of reform will continue, the implementation of various policies will be highly uneven, owing to these internal difficulties:
 - Traditional endemic systems of *guanxi* (personal relationship) networks, favoritism for relatives, going through the “back door” and other traditional methods of doing business will not speedily be abolished, if at all.
 - Senior officials who fear that retirement will bring loss of power, prestige, and perks will continue to resist some elements of reform.
 - Concerns will abide, especially among lower ranking cadres, that the reforms will not endure.
 - There will also be concerns that the rapid opening to the West will allow “unhealthy influences” to enter China and will also make it too dependent on foreign countries.
- *A myriad of technical, financial, and managerial obstacles will impede the ability of China, a huge, still backward LDC, to meet its reform goals*. Some of these problems are not wholly within China’s own ability to control and are crucially important infrastructure gaps in energy and transportation.
- Finally, the effort to modernize will create *disruptive economic and social problems* such as inflation, corruption, income disparities, regional inequalities, and occasional outbursts of social discontent.

How the party approaches these issues, and the particular scope, character, and pace of reforms over the next few years, will be influenced significantly by how well the succession to Deng takes place.

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We now believe that the mechanisms are in place for a fairly orderly succession, and that the leadership that follows Deng, for the most part, will share the goals and priorities he has set. These successors will be prepared where necessary to adjust the pace of reforms, from time to time, when faced by marked political hesitance and economic, technical constraint. []

The maintenance of reforms will also be affected significantly by external forces. China's ambitious revolution will not be taking place in a vacuum but in a broad context of interacting outside pressures on China: most notably from the USSR, the United States, and Japan. In this setting we believe that the Chinese will continue to perceive that they are not imminently threatened by the Soviet Union and will have time to concentrate resources on economic modernization. China will, meanwhile, continue to value its economic ties to the West and Japan and will continue to push strongly for infusions of foreign technology and investment. []

Despite the many hazards that will confront China's modernization effort, *we believe the most likely outcome over the next decade will be a general continuation of reform and an uneven but gradual growth of China's economic strength, stability, and power.* This means that, in broad terms:

- The reforms will for the most part bring reasonable prosperity and will give most of the populace a stake in the continuation of reform.
- An avowedly centrally planned economy will attempt to make increasing use of both market forces and political intervention and will encourage flexibility and competition within certain carefully prescribed sectors.
- The economy and the society will in many respects be opened up still more than at present but without the party losing its pre-eminence and control or the society losing its distinctively Chinese Communist character.
- The pace of reform will be uneven, progress will be start and stop, there will be incessant disputes over priorities and scope, and leadership shifts will occur as various members of the second generation attempt to strengthen their respective power and authority. *But, we believe such developments will not lead to major turmoil, as occurred during the Cultural Revolution, and will be more or less confined to the type of political struggle we have witnessed over the last eight years or so.*

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- China will develop an extensive web of interlocking trade, technological, and financial relationships with other countries—mainly Western countries and Japan—but this will include markedly expanded ties to the USSR.
- China will conduct a foreign policy that is more activist, including competing more assertively with newly industrialized countries to sell to foreign markets, maintaining an aggressive policy of arms sales abroad, and playing one country off against another in order to obtain the best possible terms for foreign markets and investments. Beijing's foreign policies will nonetheless seek above all to avoid such external conflicts as might interfere seriously with China's primary focus on modernization.

Should this "most likely" projection prevail, with China's modernization effort meeting modest success, the significance for the United States will be profound. Among the principal consequences:

- The growth of Chinese power will be gradually accompanied by a corresponding expansion of Chinese regional and global interests. China will feel more confident and capable of promoting its interests in the strategic triangle and probably will genuinely move toward its avowed objective of an "independent" foreign policy.
- China will continue, and perhaps escalate, its pressure on the United States to reduce arms sales to Taiwan, and will increasingly pressure the United States to convince Taiwan to accept Beijing's terms for national reconciliation.
- There will be continuing opportunities for US trade and investment, as China will want to continue its favorable economic and other ties to the United States and other Western countries. How willing Beijing will be to continue to mute some of its more nationalistic goals—such as recovery of Taiwan—to achieve these benefits, as it has in the past, is uncertain.
- There will also be some opportunities for a limited expansion of US military cooperation with China, primarily in the regularization of exchanges at various levels. However, China will not wish to rapidly expand military hardware acquisitions from the United States.
- The gradual growth of Chinese power and influence will complicate US relations with other countries in East Asia. Some countries will increasingly try to persuade the United States to place restraints on its assistance to Chinese military modernization.

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- China will continue to be wary of the Soviet strategic threat and of Soviet intentions, but will likely be increasingly willing to engage in various forms of economic and other exchange with the USSR; China may also eventually be willing to restore party ties. However, these improved economic and political ties will not lead to Chinese cooperation with the Soviets against the United States, because the United States and the West will remain more important than the Soviets as a source of technology, investment, and other economic advantages. []

Though less likely than the projection posited above, another plausible scenario is one in which the technical and political problems we have noted gradually overwhelm the reforms. Such an outcome would be one stopping short of total collapse or total failure of reform, but one most likely to result in a permanent recentralization of authority and a tightening of economic controls. A more centralized and repressive regime probably would not be able to resolve China's economic problems, and popular support would dwindle over time. This alternative is also likely to be accompanied by an upsurge in Chinese nationalism. The Chinese probably would blame the developed countries for their problems, but are also most likely to be suspicious and hostile toward the USSR. China probably would escalate rhetoric identifying with various Third World causes and might allow territorial problems with its neighbors to become more serious. We believe, however, that the political unrest and nationalistic excesses on the scale of the Cultural Revolution would be unlikely. []

If this scenario were to unfold, there would be greater challenges for the United States since China probably would become even more stubborn in asserting its regional demands. The Hong Kong settlement could unravel, causing the Taiwan issue to become more difficult. There would likely be setbacks across the board in economic, scientific and technical, and cultural cooperation, though we do not believe these would be abandoned altogether. Suspicion and hostility toward China by Japan and Southeast Asian countries could increase, and these countries would likely put greater pressure on the United States to avoid policies that had the appearance of strengthening China. Some Chinese leaders might want to further reduce tension with the Soviet Union and perhaps even develop closer ties to replace links to the West, but others would continue to resist, harboring lingering suspicions of Soviet intentions. []

As for other alternative futures, we believe that there is almost no likelihood that either a dramatically more rosy or a dramatically more pessimistic scenario for China will prevail. For China to succeed in its

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reforms well beyond our projections, it would require fundamental changes in the political, economic, and social system that are not in the cards during the period of this Estimate. Likewise, we believe that the party and people would not countenance a new "Cultural Revolution," even if the reforms failed miserably. Even if either possibility occurred, the forces that would produce such a change would be so cataclysmic as to preclude an effective estimate of how US interests might be affected. It is safe to say, however, that either a much more powerful China, or one that is wracked by turmoil, would pose greater albeit different challenges to the United States and would not be in our interest.

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DISCUSSION

Origins of the Reforms

1. At the heart of China's second revolution is the question of how China will modernize, an issue that has animated all Chinese political groups in the 20th century. With the ending of the Cultural Revolution and Mao Zedong's death in 1976, many Chinese were convinced that Mao's course had been disastrous. The Communist Party's leadership was seriously questioned; the economy was in bad shape and getting worse, and a sense of malaise throughout society was growing. This situation enabled Deng Xiaoping to make a comeback and to begin to reestablish and consolidate his position. []

2. Since the Third Plenum of the 11th Central Committee in December 1978, Deng has effectively led a group of other reform minded leaders in achieving major political and economic renovations, which are now also producing fundamental social change as well. These leaders, while accepting and defending the primacy of the Communist Party and the maintenance of a Marxist-Leninist state, have rejected many of the policies identified with Mao, particularly the extremism of the Cultural Revolution. Though not entirely in agreement among themselves as to the scope and pace of change, they have identified key areas in which change is necessary if China is to enter the next century as a modernized, unified, stable, and powerful state. In their view:

- The leadership of the Communist Party and the vitality of the state can only be assured if authority is successfully institutionalized rather than being vested in one charismatic leader.
 - Comprehensive economic modernization and improvements in the standard of living require material incentives and cannot be achieved by relying principally on normative exhortations and coercive campaigns.
 - Modernization also requires that ideological precepts endorse scientific and technical rationality rather than undermining it as Maoist dictums on "red versus expert" did.
 - To obtain the necessary ingredients for modernization, China must increasingly interact with the outside world, particularly the West and Japan.
- []

3. Since the Third Plenum, Deng has had to contend with various forms of opposition to his reform agenda. He has compromised when necessary but has been highly effective in getting much of his agenda adopted. There has been significant change in the nature of the Chinese policy debate in the past seven years. Unlike the earlier period of Communist rule in which wide policy oscillations were the norm, the reform program has progressed to the point where debate and policy conflict are over pace, scope, and tactics rather than on whether reform is needed. In other words, even Deng's opponents favor reform. Even if the Chinese only "muddle through" in the next few years, it is unlikely that there will be dramatic leadership or policy shifts over whether reforms are desirable. []

The Political Agenda

4. Deng and his supporters have said that for the entire reform agenda to succeed, both political structures and key personnel must be changed. They have championed a number of institutional changes to enhance the efficiency and legitimacy of the party. These involve:

- *Reorganizing the party.* The key changes include the rehabilitation of the Secretariat, the abolition of the Chairmanship, and the restructuring of commissions within the Central Committee. The purpose is to provide more discipline and responsiveness to party organizations.
- *Separating party and state functions.* There has been a major reorganization of the state apparatus, including the restoration of the position of President of the People's Republic, a reduction in the number of ministries in the State Council with a corresponding reduction in the number of Vice Premiers, and an effort to set up a new state military commission. Deng has said that the party should withdraw from a policy implementation role and should focus on leadership. The purpose here is to prevent the concentration of power in one organ or person, an abuse that Deng believes led to the excesses of the Cultural Revolution.

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Reform Benchmarks

January 1975—First Session, Fourth National People's Congress. Premier Zhou Enlai's report calls for increased efforts to promote the "four modernizations": of agriculture, industry, national defense, and science and technology. Political infighting in the Politburo delayed implementation of specific policies.

December 1976—Third Plenum, 11th Central Committee. Deng Xiaoping begins to assume leadership, eclipsing Party Chairman and State Council Premier Hua Guofeng; reform program initiated.

February 1980—Fifth Plenum, 11th Central Committee. Some key opponents of reform purged thereby weakening "leftist" influence in the Politburo; Party Secretariat established.

August-September 1980. Deng proposes separation of party and government functions, emphasizes collective leadership and retirement of superannuated officials to open door for more highly qualified personnel; Hua replaced as Premier by Zhao Ziyang.

December 1980. Politburo suspends Hua from official duties. Deng assumes leadership of Central Committee Military Commission; Hu Yaobang takes charge of party bureaucracy.

June 1981—Sixth Plenum, 11th Central Committee. Hu replaces Hua as Party Chairman; over some opposition, Deng wins approval of "Resolution on Party History," which is sharply critical of many of Mao's policies and some of his ideological precepts.

September 1982—12th Party Congress. New party constitution abolishes Chairmanship. Hu becomes General Secretary; Agricultural "responsibility system" implemented on national basis.

November 1982—Fifth Session, Fifth National People's Congress. New state constitution adopted, which restored position of President, Peoples Republic of China, fixes terms of office for most top state officials at five years, and replaces communes with townships as basic administrative unit.

October 1983—Second Plenum, 12th Central Committee. Kicks off party "rectification" campaign designed to weed out "leftist" and incompetent cadres at all levels of the party.

October 1984—Third Plenum, 12th Central Committee. Resolution adopted extending reform to include government control of industry, some price controls, and central planning.

September 1985—Party Conference of Delegates. Retires large number of aged party, government, and military leaders; approves the principal direction of the Seventh Five-Year Plan.

March 1986—National People's Congress. Approves Seventh Five-Year Plan, which calls for modest economic growth and reaffirms China's commitment to reform and the "open door" but contains no new reform initiatives.

— *Revamping ideology.* While defending the legitimacy of "Marxism-Leninism-Mao Zedong Thought," the reformers are redefining it to support their pragmatic policies. Gone is the emphasis on "class struggle," "better red than expert," and other Maoist ideological exhortations. Now ideology must make acceptable market forces in the economy, foreign investments, and other policies that "seek truth from facts"; the legitimacy of party authority increasingly is explained in economic performance terms rather than more obscure theoretical constructs.

— *Establishing the principle of legality.* Besides reinvigorating legal institutions, such as the procuracy (which prosecutes cases) and the courts, and enacting a legal code and new laws affecting all facets of society, Deng and his associates have created the expectation that there will be some limits on the exercise of authority by the state.

Increased predictability and controls on the arbitrary exercise of authority will enable the regime to obtain greater commitment from its citizens, especially the intellectuals whose willing participation is required if modernization is to work.

5. A major effort is also being made to invigorate institutions by recruitment policies that favor younger and more educated people. Without completely abolishing widespread family favoritism and *guanxi* (personal relationship) networks, Deng and his supporters are implementing a personnel system which:

— *Establish an age limit for various offices in party and government.* An age limit of 65 for government ministers and 60 for vice ministers has been established. The age limit is 68 for ordinary Central Committee members but for Politburo members the age is uncertain; press sources indicate that it ranges from 70 to 72.

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According to Deng, 81, a "few old cadres" will keep their positions "for a while." According to General Secretary Hu Yaobang, 70, the retention of some older veterans who are still in good health is the "common desire" of the entire party membership and "in their fundamental interest." Since 1984, 47 ministers and directors of Central Committee and State Council Departments have been replaced, along with 60 of their deputies. At the provincial level, 14 of the 27 provincial-level administrative units have had new party secretaries, and 10 have had new governors. Nearly all of these changes reflect the new age limitations.

— Ensures that better educated and more qualified personnel are appointed to party and government positions. More than three-fourths of the 64 new members of the Central Committee appointed at the September 1985 National Conference of Delegates had received higher education—meaning a college degree or training at a technical school or military staff school. This emphasis on educational qualifications now extends throughout the system.

— Promotes persons who will be supportive of the reforms. The age restrictions have enabled Deng to remove some senior leaders opposed to his policies, while the new recruitment guidelines help him to place his proteges in key positions.

6. Deng and his supporters believe that these political changes are vital if China is not to experience the excesses of the Cultural Revolution, when one individual was able to manipulate the levers of power, wreaking great havoc on the nation.

7. These changes do not mean that the system of favoritism for relatives and *guanxi* networks endemic to Chinese political life will be speedily abolished. Evidence suggests that children of high-ranking officials are heavily favored in recruitment for desirable positions in government and industry, and *guanxi* plays a very significant role in determining who will be promoted. For example, it is strongly believed that the newly appointed Ministers for Public Security and State Security were chosen not primarily because of their qualifications, but because of their personal ties to Hu Yaobang.

8. Reformers are not political liberals who favor individual rights and democratic procedures. Quite the contrary, they are deeply committed to what they

¹ For a discussion of this issue, see CIA Research Paper EA 85-10207 (Secret) December 1985, *The "Princes' Party" Cadre Offspring in China*. (u)

"Socialist democracy is not capitalist democracy nor individualistic democracy but a democracy for the majority of people. It can be separated neither from dictatorship over our enemies nor from centralism based on democracy. . . . We should not pursue capitalist liberalization. Pursuing capitalist liberalization in our country is equal to following the capitalist road, which will inevitably do great damage to the political situation of stability and unity and the four modernizations program."

— From an article by "Commentator" in *Hongqi* (Red Flag), 16 November 1983.

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term "the four basic principles," namely, adhering to the socialist (Communist) road, upholding the people's democratic dictatorship, upholding the leadership of the Communist Party, and adhering to Marxism-Leninism and Mao Zedong thought as interpreted by them.

Revitalizing China's Economy and Society

9. As Deng and his supporters seek to reform Chinese politics, they also recognize that the success of the second revolution also hinges on achieving economic progress. Among the most important areas are:

- Narrowing the scope of central planning and gradually allowing market forces to determine more economic activity, while maintaining economic stability by means of monetary and fiscal policies.
- Improving efficiency, productivity, and quality in production by providing enterprise managers and farmers more authority over planning, output, and marketing; by demanding greater fiscal responsibility; and by breaking up vertically organized relations and encouraging competition between economic units.
- Raising the standard of living by allowing more individual freedom to exercise entrepreneurial skills and accumulate wealth, and by promoting more production of consumer goods while developing new policies to help the economically disadvantaged.
- Developing more effective financial institutions to improve allocation of funds, monitor enterprise activity, and influence the rate and direction of economic development.

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- Gradually eliminating government intervention that stifles economic growth, such as controls on prices, rents, and wages.
- Promoting development of a relatively unregulated tertiary economic sector, such as service industries, small-scale transport, and marketing.
- Opening China's economy to foreign participation in order to acquire advanced technology, investment capital, and management skills.
- Giving priority to existing industrial bases.

10. The political and economic reforms are being accompanied by social changes as well. Chief social goals include:

- Revamping the education system, giving priority to scientific and technical skills. Admissions to colleges and universities are to be based on qualifying examinations, and a system of degrees has been restored.
- Easing limits on artistic and cultural expression.
- Giving intellectuals a more prominent role in party and government affairs and extending greater prestige to intellectual endeavors.
- Easing public restraints over religious observance and over cultural expression by national minorities.

These social changes are seen as necessary for creating greater popular support for the party. Nevertheless, some key controls will remain in place: birth control, migration, and labor unions.

Military Reforms

11. Deng and his reformist colleagues want a military that is leaner, more professional, and better trained and armed. In pursuit of this objective they have:

- Pushed for a younger and more educated officer corps with greater technical specialization. Older officers have been forced into retirement and younger ones promoted.
- Begun implementing a reduction in the overall size of the armed forces by over 1 million personnel, from about 4.5 million to 3.5 million. This is being done to save money and improve the quality of recruits.
- Reduced the role of military units in the economy—for example, they have taken the Railway

Construction Corps and the Capital Construction Engineer Corps out of PLA control—while at the same time using many defense industries for civilian production.

- Reorganized military regions and commands to simplify command and control.
- Acquired and deployed improved weapons and equipment from foreign and indigenous sources.

12. Through these changes in the PLA, Deng believes that its mission of providing national security can be accomplished more effectively and less expensively. At the same time, the military as an institution may become less likely to play a significant domestic political role to the degree it did during the Cultural Revolution. Thus far, there have not been substantial increases in the military budget—the published military budget has actually been somewhat reduced since 1979—but should the PLA go forward with announced intentions of improving weapons technology, costs could increase substantially. In any case, the success of the military modernization depends on the success of the economic program. We believe that the reformers will hold to their policy of selectively and gradually improving weapons technology, avoiding the expense that would be entailed in a rapid buildup.

Accomplishments

13. The reforms have already had a fundamental impact on Chinese politics, economics, and society. More than 1.2 million cadres at various levels have been retired. Of 200,000 younger cadres promoted to posts at or above the county level, 60 percent have college or university degrees. At the most recent party conference of delegates in September, 10 elderly members of the Politburo resigned and were replaced by six younger persons, and 64 older members of the Central Committee resigned in favor of younger and more technically qualified persons.

14. Even more dramatic have been the economic changes in China. Annual growth over the past few years has been running at about 9 to 10 percent, well above the growth target Beijing needs to accomplish its goal of quadrupling the total value of industrial and agricultural output by the year 2000 (see table). The

¹ For an analysis of developments at the Party Conference, see Intelligence Assessment EA 83-10197, (Secret) November 1983, *China's Party Conference: The Waning of the Ancient Regime*. (U)

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China's Goals for Economic Development

(Gross value of industrial
and agricultural output
[GVIAO] in billion yuan)

	Actual Production in Current Prices	Production in 1980 Yuan in Comparable Prices		
	GVIAO	GVIAO	GVAO	GVAO
1975	417	480	316	170
1980	708	708	490	218
1985	1,327	1,156	840	341
1990*		1,677	1,205	415
1993*		2,179	1,537	602
2000*		2,831	1,979	872

*Total may not add due to rounding.

* Projected. Source: Premier Zhao Ziyang's report on Seventh Five-Year Plan, March 1986.

* Projected. Source of target for the year 2000 is CPC Central Committee's goal of quadrupling 1980 GVIAO. Goal for 1985 is derived as midpoint between 1990 and 2000 goals. If targets of Seventh Five-Year Plan are reached (1990), subsequent goals will likely be raised.

This table is Confidential

"contract responsibility system" has led to an unprecedented boom in many of China's rural areas, both in terms of productivity and peasant income.

15. The overall standard of living of the Chinese people has improved considerably. Coupon rationing has ended for clothing and most foods. Rural dwellers have seen their annual per capita income more than double since 1978, up to about 300 yuan. The gap between rural and urban living standards has narrowed significantly. There is a wider variety of products and consumer goods available.

16. The reforms are perceived by most Chinese as having delivered the goods thus far, and the reformers are counting on popular support to keep the momentum going. Chinese leaders repeatedly assure foreign visitors that the reforms are highly popular and for this reason can be successfully continued.

Reform Obstacles

17. In spite of these accomplishments, the pace of reforms and the degree of implementation have been and will be uneven because of both technical obstacles and political resistance. Among the chief technical obstacles are:

- *Problems in developing the managerial talent.* Many economic managers have successfully achieved goals based on quantitative production

but are now expected to perform in an environment that demands quality, innovation, marketing skill, and profits. The educational system will have great difficulty providing the skilled managers China needs.

- *Shortcomings in financial capabilities.* As the 1985 foreign exchange scare—in which the Chinese discovered their reserves were being depleted much more rapidly than anticipated and moved quickly to regain central control over outflows—amply demonstrates, China may have difficulty committing the financial resources necessary for infrastructural development at the appropriate time. Additionally, the unleashing of strong inflationary pressures by the reforms has disrupted both investment and planning.
- *Difficulties in acquiring and absorbing technology.* Certain technologies are unavailable owing to COCOM restrictions or because Western enterprises refuse to provide it, fearing that the Chinese will subsequently use it to compete with them. Even so, Beijing has acquired expensive technology from abroad only to have it remain unused for want of trained personnel.
- *Infrastructure gaps in such crucial areas as energy and transportation.* China's short-term

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Special Economic Zones:
A Test of the Reforms *

At the urging of Deng Xiaoping, in 1979 the State Council authorized the creation of special economic zones as part of a policy directed at liberalizing the foreign trade system and opening the economy to the West. Four zones were established to spur and concentrate foreign investment. Xiamen and Shantou designed to concentrate on developing export processing industries and Shenzhen and Zhuhai, bordering on Hong Kong and Macao respectively, designed for more diversified development. All four zones offered investors low-cost labor, reduced rents and taxes, and scaled down or waived customs duties. They sought to attract foreign investment in infrastructure projects as well as in industries that would promote exports and enhance technological development. Responding to the charge of critics that the Special Economic Zones (SEZs) were like the treaty ports of the past, the reformers asserted that unlike the situation in the past, foreign involvement would be on Chinese terms, not forced by the foreigners. []

Initially, the development of the SEZs was sluggish, but beginning in 1983 there was rapid expansion, particularly in Shenzhen. By 1984 Shenzhen had attracted 70 percent of the total foreign funds invested in SEZs and 15 percent of total realized foreign investment in China. This, together with heavy state investment in infrastructural projects, resulted in a major boom. In early 1984, Deng visited Shenzhen and praised the results. His visit seemed to allay concern that the SEZ experiment would be short lived. Indeed, the gross value of industrial and agricultural output in the four zones went from 2.1 billion yuan in 1983 to 3.3 billion yuan in 1984, with Shenzhen accounting for about 50 percent of the growth. []

* See INR Report 1120-AR, China's Special Economic Zones: Less Progress than Meets the Eye, 2 July 1985. (c)

However, some unforeseen results caused Chinese policymakers to again have second thoughts. Most of the investment has gone into construction rather than increases in production; also, only about one-third of sales from the SEZs have been made abroad, while two-thirds have been in China. Export goals for Shenzhen were supposed to reach US \$5.2 billion by 1990, but between 1980 and 1983 they increased only from US \$11.2 million to \$21.1 million, a tiny fraction of official projections. In 1984 the four zones ran a trade deficit of US \$2 billion. In general, the SEZs have failed to serve the anticipated investment function and have failed to attract technology-intensive industry. Also, there is some consternation that they have led to corruption and the spread of "spiritual pollution" in China. []

In mid-1985 Chinese leaders seemed to be hedging their bets on the SEZs. Deng referred to them as "experimental" and suggested that they could be shut down if their purpose was not achieved. Gu Mu, who carried the SEZ portfolio in the Secretariat, gave SEZ performance a mixed review in a newspaper interview in April 1985. Gu was removed from the Secretariat at the Party National Conference of Delegates in September. []

The SEZ's lackluster record in obtaining key objectives has probably tarnished the credibility of the policy, if not the policymakers. Reformers are nimbly switching their strategy for China's modernization and are now focusing on upgrading technology in major industrial centers through licensing agreements and joint ventures. However, it seems unlikely that the SEZ concept will be abandoned; rather, they will most likely record modest gains as they compete with other opening Chinese industrial cities for foreign investment. []

energy approach involves dependence on coal-fired plants, which create pollution and place an added burden on mining and transportation. The long-term plan calls for expensive nuclear and hydroelectric projects, which will have no payoffs until the 1990s. Transportation is a serious problem, which only substantial investment can help to solve. Chinese railways are 70 percent overbooked, and port congestion is extremely severe. Attempts to increase highway use for short haul commerce will be costly and will increase demand for fuels that the energy sector may not be able to provide. []

18. Reform policies have generated or exacerbated a host of serious difficulties in China's economy.

Among these problems are double-digit inflation, a rise in official corruption, socially disruptive income disparities, and regional inequality. These problems have generated both social discontent, as measured by student demonstrations, and political controversy at the highest levels. []

19. There is also political resistance to the reforms. Significant issues include:

- *Strong differences among the leadership as to the extent and pace of reform.* Some leaders have tried to slow and modify the reforms because they believe that moving too rapidly and too far is undermining party authority.
- *The fear of losing power and perks among senior officials who are being retired.*

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We must intensify ideological and political work and preserve the prestige of the party's departments in charge of this work. There are now some people, including some party members, who have forsaken the socialist and Communist ideal and turned their backs on serving the people. Some of them have become rich by unlawful means such as speculation and swindle, graft, and acceptance of bribes. In their dealings with foreigners, they have no consideration of personal or national dignity. These problems can be attributed to the relation of ideological and political work and the decline in the function and authority of departments in charge of such work. We should take this as a lesson. Party organizations at all levels should conduct ideological and political work in earnest and safeguard the authority of those departments.

— Chen Yun, speech at CCP National Conference of Delegates, September 1955.

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— *The concern among some officials, particularly lower ranking cadres, that the reforms will not endure. These officials adopt a "wait and see" attitude and move slowly and cautiously, if at all, in implementing directives.*

— *Concern that the rapid opening to the West will allow unhealthy influences to enter China and will also make China too dependent on foreign countries.*

20. Thus far, both Deng and his opponents have sought to avoid a showdown on the issue that must inevitably arise: will economic modernization require a loosening of ideological strictures and political controls? To date we judge that the party remains deeply divided on this issue. The dilemma of trading political control for improved economic performance will remain for the next 10 years.

Deng's Mortality³

21. The party's ability to overcome obstacles to reform and to continue with the second revolution hinges on how orderly the succession to Deng is accomplished. The mechanisms are in place for an orderly succession, but the future of reform depends on the nature, character, and policies of Deng's successors. Deng has given a high priority to putting in place those persons he deems most committed to reform, yet

³ On prospects for the succession to Deng, see forthcoming SNIE 13-86 (Secret) May 1986, *China After Deng: Succession Problems and Prospects*. (c)

he has also had to accept the promotion of proteges of other leaders, including those who have been opposed to some elements of the reforms. Reform success owes much to Deng's political skills and ability to negotiate among competing interests. We doubt that his successor will have the same commitment to reform or his negotiating ability. Nevertheless, we believe that the leadership that emerges after Deng for the most part will share his goals and priorities even though it will include some who favor a different approach.

External Influences

22. China's reform effort has been perceptibly influenced by external forces and will continue to be so over the coming decade. Of particular importance has been the shift in Chinese perceptions of threat and a corresponding shift in foreign policy emphasis. Chinese demands for a "united front" against Soviet "hegemonism," heard during the high tide of Sino-US cooperation in 1979, have given way to the declaration of an "independent" foreign policy that seeks to treat the superpowers more evenhandedly. While there has been no substantive Soviet change on key issues that divide Beijing and Moscow, Chinese perceptions have shifted. They believe:

— The United States has increased its power and vigilance against the Soviet threat.

— The Soviets are becoming overextended in their activities in Afghanistan and Vietnam and are also distracted by their problems at home and in Eastern Europe.

— Avoiding armed conflict is essential so that China will have time and resources to modernize.

— New Soviet leadership might be eventually more forthcoming on China's three major conditions for normalizing relations.

In the past few years, China's stated rationale for cooperation with the West has progressively shifted from the strategic countering of Soviet power to their expressed desire for financial and technological support for China's modernization.

23. China has fostered improved ties to the Soviet Union, and rapid gains in trade, perhaps as much as \$6 billion annually by the end of the decade, are anticipated in the 1986-90 trade agreement concluded by the two parties. Though far less than China's trade with the West, this trade expansion is evidence of

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Chinese willingness to obscure or overlook some political differences while seeking modernization. In particular, the Chinese probably will continue to use care in dealing with especially sensitive issues in order not to jeopardize potential Soviet contributions to Chinese modernization. []

24. The pace and degree of Chinese reforms are partly influenced by how successful the Chinese believe they will be in acquiring modernization resources in the West, principally from the United States. The United States is currently the largest foreign investor in China, after Hong Kong, and has worked to promote trade and economic cooperation. There are 15,000 Chinese students in the United States, the largest number abroad in any country, and the reformers perceive that these students are a fundamental means of acquiring expertise. We believe that Beijing is increasingly concerned with issues such as trade, investment, student exchange, and the US role in COCOM restrictions on China. Chinese attitudes toward military cooperation with the United States are mixed. Some elements of the leadership favor limited military cooperation as a means of promoting military modernization while others want to downplay such cooperation. []

25. Chinese leaders believe that Japan can make an important economic and technological contribution to China's modernization, but they remain suspicious of Japanese intentions. There are mixed feelings about Japan's role in such projects as the Baoshan steel project that helped to modernize China's steel industry but at enormous expense. Deng recently stated that continuing trade deficits with Japan were unacceptable, while others have complained of Japan's lack of investment in China. Below the surface of official good will between the two nations, there is lingering hostility as evidenced by student demonstrations against Japan in the fall of 1985. []

China's Future: The Most Likely Prospect

26. Deng and his reformist colleagues have already scored remarkable achievements in reorganizing the political infrastructure and improving economic productivity in certain sectors, such as agriculture, where reform policies have been applied most extensively. The economic reforms in China have brought unprecedented prosperity and have given the people a stake in the continuation of reform. Reform policies have been implemented in a "two steps forward, one step back" fashion, and we expect this pattern to continue. We believe, on balance, that the Chinese leadership

has demonstrated sufficient success in achieving their goals of creating a more united, stable, and powerful China, and that the general trend of reform will continue during the period of this Estimate. []

27. Nevertheless, we believe that over the next 10 years there will be continuing political and economic problems facing the Chinese leadership that have a potential to threaten reform. That is, there will be incessant disputes over the scale, pace, and side effects of reform, and leadership shifts will occur as various members of the second generation attempt to strengthen their respective positions. But, we do not believe these will lead to major turmoil, as occurred during the Cultural Revolution, and will be confined to the type of struggle that we have witnessed since the Third Plenum in 1978. []

25. Economic performance is most likely to support a continuation of reform policies. Despite problems with excessive growth, inflation, and corruption, China's robust economy (see table) has generated popular and political support that probably will carry the leadership through the inevitable cyclical downturns and lean years. The reformers' ability to discover and respond to problems in the economy has been an important factor in their record of success, and we expect this flexibility to be maintained. []

29. Over the next 10 years, key features of a developing China probably will include:

- A party leadership that dominates policy formulation across the board.
- A bureaucracy staffed by relatively young, technically capable personnel.
- A social system that reflects tensions between economic liberalization and political control.
- An avowed centrally planned economy that attempts to make use of both market forces and political intervention to influence its development and encourages flexibility and competition within certain carefully described sectors.
- An extensive web of interlocking trade, technological and financial relationships with other countries, mainly Western and Japan.
- An approach to foreign policy issues that is more activist but dominated by a desire to avoid unnecessary external conflict that would interfere with a continuing focus on modernization.

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30. As China becomes more prosperous, its foreign policy options will increase. It will seek to play a greater role in international and regional affairs. China will publicly adhere to its "independent" posture and will rhetorically support various Third World positions in the United Nations and in other international forums. At the same time, China will continue to emphasize orderly economic, financial, and trade ties to the West. Within Asia, China will seek to augment its role as a regional power, recognizing that the United States and the USSR are actively engaged in the region, but seeking over the longer term to reduce that involvement. Specifically, we believe that China will:

- Increasingly seek arrangements in Korea that will enhance prospects for peace and stability in the peninsula.
- Continue to demand a solution to the Cambodia conflict that acknowledges Chinese interests and influence in Indochina.
- Attempt to avoid military action except perhaps in the South China Sea where overlapping territorial claims involve several countries, including Vietnam. []

31. We believe that China will not move significantly closer to the Soviet Union. Normalization of Sino-Soviet relations may move forward, perhaps even including a restoration of party to party ties. Even in that exigency, the Chinese will not cooperate with the Soviets against the United States, because the West will remain more important to China as a source of technology, investment, and other economic advantages. China will improve economic relations with the USSR but will most likely continue to regard the Soviet Union as a major competitor for influence in East Asia and a strategic military threat. []

32. Greater production of a wider range of goods will mean that China will compete more assertively with newly industrialized countries to sell to foreign markets, especially in the developed countries. China will also maintain an aggressive policy of arms sales abroad, which, with technological improvements, will make it increasingly competitive in this market. China's increasing economic strength will make it even more attractive to foreigners in both market and investment terms, which in turn will enable the Chinese to play one country against another in order to obtain the best possible terms. Developing countries in East Asia will feel increasing pressure from China's development. []

A Less Likely Alternative: The Reforms Collapse

33. We believe that another plausible though less likely outcome is a situation in which technical and political problems gradually overwhelm the reforms. This would entail a permanent recentralization of authority and a tightening of economic controls. Such a situation could be brought about by:

- A series of major economic setbacks, such as runaway inflation, successive poor harvests, or stagnant industrial growth.
- Widespread demands for greater personal and political freedoms that appear to threaten the party's control.
- Political unrest among segments of the population resulting from a perception of disadvantage. []

34. Should these, or other potential developments, result in the ending of reforms, we would anticipate the following situation:

- Intensified infighting among party elites, accompanied by signs of policy immobilism and ideological dogmatism.
- Growing tension in the bureaucracy as technically qualified personnel lose authority to anti-reform party ideologues.
- A social system characterized by increasing unrest as the regime moves to dismantle reforms and reimpose central authority.
- The broadened application of central planning and limitations on market forces in the economy.
- An increased emphasis on self reliance, perhaps including attempts to limit foreign participation in China's economy.
- A foreign policy lacking initiative but pursued in a truculent manner. []

35. This more centralized and repressive regime probably would not be able to resolve China's economic problems, and popular support would dwindle over time. This alternative could also be accompanied by an upsurge in Chinese nationalism. The Chinese would be most likely to blame the developed countries for their problems but would remain suspicious of Soviet intentions toward China. China would escalate its Third World rhetoric and might allow territorial problems with its neighbors to become more serious. The Hong Kong settlement could unravel, causing the Taiwan issue to become more difficult. We believe, however, that political unrest and nationalistic excesses on the scale of the Cultural Revolution would be unlikely. []

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Can China Dramatically Succeed or Fail Beyond Our Expectations?

36. We believe it is highly unlikely that the Chinese reforms will succeed dramatically or fail miserably. In order for the reforms to accomplish much more than we anticipate:

- The role of the party would have to be further diminished and greater political pluralism introduced.
- Marxist-Leninist ideology would have to cease to be the basis of legitimate authority.
- The bureaucracy would have to become much more technically skilled and insulated from political shifts.
- The economy would require much less government intervention and would give primacy to market forces.
- In exchange for Western know-how and technology, China would have to grant much greater foreign access to its domestic markets.

Over the period of this Estimate it is highly unlikely that the Communist Party would countenance changes of this magnitude, preferring to maintain control rather than rapidly accelerate the pace of modernization. []

37. It is also highly unlikely that the reforms will precipitate a major economic or political collapse with accompanying Cultural Revolution style xenophobia. Causes of such a collapse would include:

- A complete breakdown of consensus among the leadership, resulting in violent political turbulence, purges, and probably military intervention.
- The emergence of regional power centers competing with Beijing for political authority.
- Extreme social polarization and the emergence of ideological fanaticism.
- Bureaucratic paralysis leading to failure to implement policies effectively.
- Stagflation, increased unemployment, crop failures and famine, or other dislocations of such magnitude that the reforms are totally discredited.

We believe that having come close to this type of political and economic collapse during the Cultural Revolution, Chinese leaders, regardless of their attitude toward reform, will try to undertake whatever steps are necessary to prevent this degree of systemic breakdown. []

Implications for the United States

38. Our most likely alternative for China's future offers a mixed but basically favorable situation for the United States. A more politically stable and economically prosperous China with increased ties to and interactions with the United States, Japan, and other Western countries has been a goal of US policy for a decade or more. In this respect, the progress of China's reforms compliment US policy. Nevertheless, the very success of these reforms will bring both opportunities and challenges for US policymakers as they deal with a more capable and confident China in the decades ahead. []

39. We believe that the key opportunities for the United States will be:

- A potential for the expansion of mutual trade and investment.
- Continued areas of political cooperation; specifically, both sides will wish to limit Soviet power and influence in the region and will want peace and stability on the Korean Peninsula.
- Some limited expansion of military cooperation, primarily in the regularization of exchanges at various levels; however, we believe that China will not wish to rapidly expand military acquisitions from the United States.
- Better cultural ties and understanding because China will wish to maintain a broad level of student, cultural, and scientific exchange.
- A potential to influence a generation of Chinese elites, exposed to the United States through a variety of exchanges. []

40. We believe that the key challenges for the United States will be:

- Continuing pressure on the United States to reduce arms sales to Taiwan.
- Increasing pressure on the United States to convince Taiwan to accept Beijing's terms for national reconciliation.
- Continuing, and perhaps escalating, demands that the United States transfer sensitive technology to China and reduce third-party transfer restrictions.
- Continuing pressure for US concessions on trade and investment.
- Growing Chinese competitiveness in East Asian markets. []

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41. The gradual growth of Chinese power and influence will complicate US relations with other countries in the region. Many Southeast Asian countries view China as an economic competitor and will become alarmed as China increases its access to US and other Western markets. Increasing Chinese military power will be viewed with concern by some Asian countries that will try to persuade the United States to place restraints on its assistance to Chinese military modernization; these countries do not appreciate the limits of US influence on China. []

42. A moderately successful reformist leadership will seek to maintain or enhance China's position within the strategic triangle. The attitude of close, strategic cooperation with the United States against the Soviet Union that China evoked in the 1970s is not likely to reoccur during the period of this Estimate. Rather, China will most likely seek to find ways to exploit differences between the United States and the Soviet Union to enhance its own position in the triangle. []

43. *In the event that our less likely, but plausible, scenario unfolds*, China would become a more serious challenge to US interests because it would probably be even more stubborn in asserting its demands. We would anticipate that:

- Cooperative Sino-US economic ties would be reduced.
- Beijing would most likely escalate its demands that the United States stop arms sales to Taiwan

— Military cooperation with the United States would be cut back

— Exchanges in scientific, technical, cultural, and other areas would falter.

— China would increasingly adopt an anti-US posture in international fora and in propaganda []

44. Under these circumstances we could expect that China would be more assertive on regional issues. China might renew moral and political ties to pro-Beijing Southeast Asian Communist movements and under some circumstances might be willing to slightly upgrade ties to these groups. While some leaders might also want to reduce tension with the USSR and develop closer ties to replace links to the West, this tendency would be mitigated by lingering suspicions of Soviet intentions toward China. []

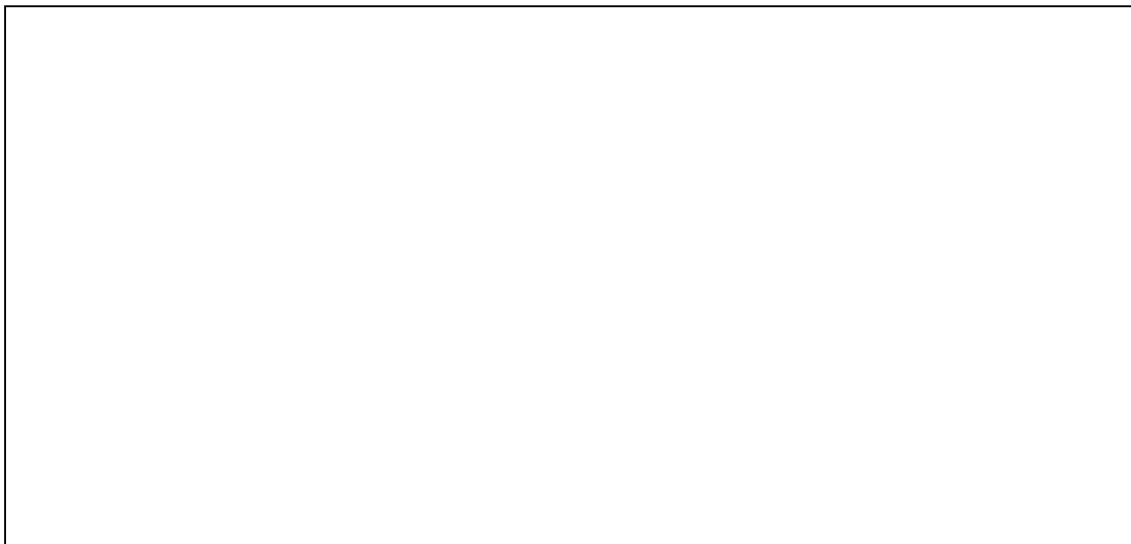
45. Reform in China is a complex political, economic, and social phenomenon whose future course cannot be precisely predicted. The continuity or abandonment of the policies and structural changes that emerge from the "second revolution" will have important implications for US interests in Asia and elsewhere. We believe, however, that stunning success or ignominious failure is not only highly unlikely, but are tied to so many imponderables as to mitigate against projecting specific implication of these alternatives for the United States. []

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ANNEX B

Short Biographies of Key Chinese Leaders



Yao Yilin

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Yao Yilin . . . 65 . . . Politburo member and Vice Premier of State Council . . . protege of conservative Standing Committee member Chen Yun . . . economic decisionmaker who advocates Chen's limited growth policies . . . shares Chen's reservations about aspects of economic reforms, particularly on China's special economic zones . . . graduate of Qinghua University . . . served in State Council posts throughout 1950s and 1960s . . . purged in 1966 . . . worked in foreign trade administration after 1973 rehabilitation . . . relieved from Secretariat September 1985 . . . handled recent bilateral economic talks with Soviet Union.



Wu Xueqian

Wide World G

Wu Xueqian . . . 65 . . . Politburo member, State Councilor and Minister of Foreign Affairs . . . posting to Politburo makes him equal of Soviet foreign minister in party protocol, extends his authority in foreign policy . . . member of party foreign affairs oversight group . . . highest ranking Hu Yaobang associate in government . . . graduate of St. John's University, Shanghai . . . joined party in 1936 . . . served under Hu as Youth League leader during 1950s and 1960s . . . purged during Cultural Revolution . . . reappeared 1972 . . . deputy head of International Liaison Department 1975-82.



Wang Zhaoguo

Wang Zhaoguo . . . 44 . . . Secretariat member . . . director of party General Office . . . nationally celebrated as model "third echelon" cadre after promotion to Central Committee in 1982 . . . personally promoted by Deng Xiaoping after impressing him in briefing . . . Youth League ties to Hu Yaobang . . . headed Communist Youth League 1982-84 . . . graduate of Harbin University in 1966 with degree in mechanics . . . auto plant manager in Hubei . . . studied at US-established Dalian Management School in 1980. (v)



Tian Jiyun

Tian Jiyun . . . 56 . . . member Politburo and Secretariat and Vice Premier of State Council . . . most prominent Zhao Ziyang protege in party and state . . . leading government spokesman for wage and price reforms . . . probably a principal drafter of October 1984 party decision to reform China's economic structure . . . joined party 1945 . . . longtime finance official in southwest . . . during 1970s helped Zhao implement experimental economic reforms in Sichuan.

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Li Peng

Li Peng . . . 57 . . . member of Politburo and Secretariat and Vice Premier of State Council . . . adopted son of Zhou Enlai and Deng Yingchao . . . oversees key energy, transportation, and education sectors . . . may side with party conservatives on some issues . . .

. . . Soviet-trained expert in hydropower engineering . . . former Minister of Water Conservancy and Electric Power. []



Hao Jianxin

Hao Jianxin . . . 50 . . . Secretary of CCP Secretariat . . . protege of Hu Yaobang . . . served under Hu as member of Communist Youth League during early 1950s . . . active in women's affairs . . . one of several Secretariat members who oversee economic affairs . . . former textile industry model worker . . . graduated from East China Textile Engineering College in 1962 . . . served as Minister of Textile Industry 1981-83. []



Hu Qili

Hu Qili . . . 56 . . . Politburo member and Permanent Secretary of Secretariat . . . became youngest Secretariat member in September 1982 . . . protege of Hu Yaobang . . . almost certainly reinforces Hu Yaobang's "liberal" proclivities . . . widely seen as next party general secretary . . . graduate of Beijing University in mechanical engineering . . . member of Communist Youth League Secretariat during 1950s and 1960s . . . purged in 1967 during Cultural Revolution . . . rehabilitated 1972 in Ningxia Autonomous Region . . . returned to Beijing 1977, resumed youth work . . . vice president Qinghua University 1978-82 . . . rose to national prominence as Tianjin mayor 1980-82. []



Qiao Shi

Qiao Shi . . . 61 . . . Member Politburo and Secretariat . . . Vice Premier of State Council . . . director of CCP's Political and Legal Commission . . . protege of Hu Yaobang . . . considerable authority in security and legal affairs . . . joined party in 1940 . . . managed youth affairs in East China during 1950s . . . headed Afro-Asian Solidarity Committee from 1965 until purged in 1967 . . . Director of party International Liaison Department 1982-83, Organization Department 1984-85. []

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